



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TEGE EO Examinations Mail Stop 4920 DAL
1100 Commerce St.
Dallas, Texas 75242

501.03-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: June 22, 2009

Release Number: 201025081

Release Date: 6/25/10

LEGEND

ORG = Organization name

Xx = date Address = address

Taxpayer Identification Number:
Person to Contact:
Employee Identification Number:
Employee Telephone Number:
(Phone)
(Fax)

ORG

LAST DATE TO FILE A PETITION
IN TAX COURT: September 21, 20XX

CERTIFIED MAIL – RETURN RECEIPT

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the Code). Our favorable determination letter to you dated August 22, 19XX is hereby revoked and you are no longer exempt under section 501(a) of the Code effective January 1, 20XX.

The revocation of your exempt status was made for the following reason(s):

Organizations described in IRC 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You are not operated exclusively for exempt purposes because you operate a program that does not exclusively serve an exempt purpose described in IRC 501(c)(3), and you provide substantial private benefit to persons who do not belong to a charitable class. You provide down payment assistance to individuals and families for the purchase of a home.

You do not screen the applicants for your downpayment assistance program. The buyer and seller have negotiated the sale before an application is made to you. Your downpayment assistance program activities do not target neighborhoods in need of rehabilitation or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination. The home sale transactions were for homes located all over the area.

Your primary activity was brokering transactions to facilitate the selling of homes. You do not engage in any counseling or other activities that further charitable purposes. Because your primary activity is not conducted in a manner designed to further IRC 501(c)(3) purposes, you are not operated exclusively for exempt purposes within the meaning of IRC 501(c)(3).

Contributions to your organization are no longer deductible under IRC §170 after January 1, 20XX.

You are required to file income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the tax year ending December 31, 20XX, and for all tax years thereafter in accordance with the instructions of the return.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination under the declaratory judgment provisions of section 7428 of the Code, a petition to the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia must be filed before the 91st Day after the date this determination was mailed to you. Please contact the clerk of the appropriate court for rules regarding filing petitions for declaratory judgments by referring to the enclosed Publication 892. You may write to the United States Tax Court at the following address:

You also have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

See the enclosed Notice 1546, Taxpayer Advocate Service - Your Voice at the IRS, for Taxpayer Advocate telephone numbers and addresses.

We will notify the appropriate State Officials of this action, as required by Code section 6104(c). You should contact your State officials if you have any questions about how this final determination may affect your State responsibilities and requirements.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

**Sunita Lough
Director, EO Examinations**

**Enclosures:
Publication 892
Publication 1546**

Internal Revenue Service

Department of the Treasury
TE/GE Exempt Organizations Examinations
915 Second Avenue M/S W540
Seattle, Washington 98174

Date: June 19, 2008

ORG
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

Certified Mail - Return Receipt Requested

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS		Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number	Year/Period ended 12/31/20XX, 12/31/20XX	

LEGEND

ORG = Organization name XX = Date Address = address City = city
State = State DIR-1 = 1st Director CO-1 == 1st Company

ISSUE:

Whether ORG operated exclusively for exempt purposes within the meaning of Internal Revenue Code §501(c)(3)?

FACTS:

Overview

ORG ("ORG") is a State State Non-Profit Corporation which filed its articles of incorporation on August 15, . The address of ORG is Address, City, State.

ORG applied to the Internal Revenue Service ("IRS") for exemption from income tax on June 2, 19XX. The letter of determination was issued on August 22, 19XX establishing ORG as an organization exempt from tax under Internal Revenue Code §501(c)(3).

In 20XX and 20XX ORG promoted and operated a down payment assistance ("DPA") program for home buyers under which it provided funds to the buyers to use as their down payment or for closing costs and collects the same amount, plus an additional fee, from the home sellers.

Application for Recognition of Tax Exempt Status

Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, was filed by ORG with the IRS on June 2, 19XX. The organization's purpose as stated on their Form 1023 is to

"provide access to affordable housing principally to low-income and very low income families and individuals in the City- metropolitan area. ORG was organized in response to the chronic shortage of safe, quality housing that is affordable to low income and very low income families, who are first time home buyers.

ORG will purchase the homes and rental units sold and leased to the charitable beneficiaries principally through its participation in Department of Housing and Urban Development Affordable Housing Program. As needed, ORG will engage the services of general contractors to renovate the homes and/or rental units prior to their sale or rental.

To ensure that the initial and continuing costs of home ownership are affordable to low-income and very low-income residents, ORG will assist the charitable beneficiaries in securing loans and making down payments and will provide closing costs. To ensure that it rental housing

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is affordable to the charitable beneficiaries, ORG will limit the tenant's portion of the rent charged, to between 80% to 85% of the fair market value for such rental housing.

ORG will also provide, at no charge, counseling, training, and resource referral to assist the charitable beneficiaries in the transition to first time home ownership and to ensure that its participant families and individuals reap the many benefits of home ownership and contribute to the building of strong communities.

Program assistance and training will be provided in English and Spanish, as necessary. Training and program services will be offered at the principal office of ORG, Address, City, State, and at the City Department of Social Services Food Assistance Program Site, Address, City, State.

ORG has modeled its first time home ownership program in part on examples provided in Revenue Procedure 96-32, 1996-1 C.B. 717, which outlines a safe harbor and a facts and circumstances test for determining whether an organization that provides low-income housing relieves the poor and distressed. The facts and circumstances that demonstrate that ORG hill in fact relieve the poor and distressed include the following:

1. Limited deviation from the safe harbor percentages set forth in Revenue Procedure 96.32.
2. ORG will make the initial and continuing costs of purchasing a home affordable to low and very low income residents by assisting such residents in securing loans and making down payments and by providing closing costs.
3. ORG will ensure that its rental housing is affordable by limiting the tenant's portion to the rent charged to between 80% and 85% for the fair market value for such rental housing.
4. ORG will participate in the Department of Housing and Urban Development's Affordable Housing Program, designed to provide affordable housing.
5. ORG will provide additional social services to the poor residents at no charge, including counseling, training, and resource referral; such services will be provided in both English and Spanish, as needed."

Federal Returns

ORG filed Form 990-PF for the tax periods ended December 31, 20XX, and December 31, 20XX. Per IRS records, ORG was not required to file and did not file Form 990-T. ORG also filed Forms 941 for the tax periods ended March 31, 20XX, through December 31, 20XX.

In 20XX and 20XX the primary activity of the organization was administering it's down payment assistance program as described in more detail below.

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In 20XX and 20XX ORG received \$ and \$ respectively, in gross revenue from amounts paid to it by sellers participating in ORG's DPA program. ORG did not report the seller's payments as contributions. Instead, ORG reported these payments as other income. ORG reported the total amount of contributions and gifts it received, from all sources, as zero. ORG also reported that it distributed \$ and \$ respectively, in down payment assistance to homebuyers for use as down payments and/or to pay for closing costs.

Down Payment Assistance Program Description.

ORG provided documentation on how their down payment assistance program was setup. The first document they provide to prospective clients is titled "Obtaining Down Payment Assistance".

The document states that ORG makes it easy to complete all of the necessary steps to obtain down payment assistance. All parties involved in the real estate transaction should follow these steps.

- Step 1** The real estate contract is negotiated between the buyer and the seller.
- Step 2** The contract must then be forwarded to the title company. The closing agent will ensure that the amounts stated on the *Down Payment Assistance Application* are correct.
- Step 3** The lender should then fill out the Down Payment Assistance Application and fax to ORG. The application serves as the sign up form for every individual in the transaction.
- Step 4** The gift letter (required by underwriting) for the buyer is prepared by ORG and faxed to the lender.
- Step 5** 48 hours prior to closing; ORG contacts the title company and lender to confirm the closing. Closing instructions are delivered to the title company along with the down payment assistance funds,

ORG also provided a document titled "Program Summary". The document outlines five aspects of the down payment assistance program of the organization for the individuals participating in the program.

1. **Total Seller Costs** (above Replenishment amount) \$.
2. **Contribution to ORG:** Replenishment amount

ORG is the source nonprofit for the Down Payment assistance Program in which 100% of the contribution made to the charitable organization go to providing homeownership assistance, education and the organization's other charitable endeavors.

3. **Replenishment amount:** Exact amount of gift funds.

The Replenishment amount is the amount needed to replenish the down payment assistance pool after gift funds have been provided to the buyer. This can be the exact amount of gift funds needed or a percentage up to 6% of contract sales price. (Typically 3% of contract sales

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price)

4. **Tax Deductible:** Home sellers can not deduct the contribution from their taxes.

Contributions are not tax deductible because the sellers expect something in return, that is the ability to sell their home and therefore lack the requisite "Donative Intent".

5. **Processing Fee:** \$

\$ - paid directly to CO-1, the processing company providing processing services to ORG.

At the closing of the sale ORG provides a document titled "Transaction Summary Seller Participation Acknowledgement and Disclosure Form". This document is included with the closing documents.

The documents lists the names of the buyer and the seller, the address of the property, the amount of the gift funds to the buyer, the name of the closing/title office, the contribution amount to ORG and the amount of the processing fee to CO-1.

The document also lists the disclosures and seller acknowledgements. There are five listed on the form, they are:

1. The amount appearing as Contribution to ORG is the amount that Seller has agreed to pay to ORG out of sales proceeds. No goods or services were provided to the Seller in consideration for this contribution. Payment of this contribution is NOT required if the Buyer does not purchase the Subject Property.
2. The amount appearing as Processing Fee is the amount that the seller has agreed to pay to CO-1 out of sales proceeds. This payment is made in consideration for processing services provided in conjunction with Seller's participation in the Down Payment Assistance program.
3. Seller understands that the Contribution is used to provide down payment or closing costs assistance to Buyer, and that gift funds are derived from pre-existing ORG funds.
4. Seller agrees to instruct and authorize the Settlement/Closing Agent to return ORG gift funds to ORG if the Buyer is unsuccessful in obtaining a loan or the loan does not close within five (5) business days after ORG gift funds are deposited to settlement or with the closing agent.
5. Seller instructs the Settlement/Closing Agent to retain and forward the contribution to ORG and Processing Fee to CO-1, upon the successful completion of settlement/closing in accordance with the Closing Instructions provided through the Down Payment Assistance program.

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The bottom of the form lists spaces for the seller/sellers, name, social security number and date.

CO-1

CO-1 was the processing agent for the DPA transactions of ORG. A \$ fee was paid directly to CO-1 for its part in processing the paperwork of the sale. There is a relationship between CO-1 and ORG in that DIR-1 is a principal participant of both organizations. There were four DPA transactions for 20XX and six transactions for 20XX. This would have resulted in \$ and \$ in fees respectively for each year.

LAW:

Section 501(a) of the Code provides for the exemption from federal income taxation of corporations described in section 501(c)(3) of the Code. To be described in section 501(c)(3), an organization must be organized and operated exclusively for charitable, educational or other exempt purposes and may not permit any of its net earnings to inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3) of the Code. An organization must not engage in substantial activities that fail to further an exempt purpose.

Income Tax Regulation §1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Income Tax Regulation §1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. To meet this requirement it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Income Tax Regulation §1.501(c)(3)-1(d)(2) defines the term "charitable" as used in section 501(c)(3) of the Code as including the relief of the poor and distressed or of the underprivileged, advancement of education, combating community deterioration and lessening the burdens of government.

Income Tax Regulation §1.501(c)(3)-1(d)(3)(i) provides, in part, that the term "educational" as used in section 501(c)(3) of the Code relates to the instruction of the public on subjects useful to the individual and beneficial to the community.

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Income Tax Regulation §1.501(c)(3)-1(e) provides that an organization that operates a trade or business as a substantial part of its activities may meet the requirements of section 501(c)(3) of the Code if the trade or business furthers an exempt purpose, and provided the organization's primary purpose does not consist of carrying on an unrelated trade or business.

In Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279, 283 (1945), the Supreme Court held that the "presence of a single . . . [nonexempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly . . . [exempt] purposes." If a substantial part of an organization's activities furthers non-charitable purposes, the organization is not operated exclusively for charitable purposes even though its other activities further charitable purposes. See Old Dominion Box Co., Inc. v. U.S., 477 F.2d 340 (4th Cir. 1973), cert. denied, 413 U.S. 910 (1973).

In Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F.2d 78 (Fed. Cir.) cert. denied, 488 U.S. 907 (1988), the court held that an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because a substantial purpose of the agency was a nonexempt commercial purpose. The court concluded that the organization did not qualify for exemption under section 501(c)(3) because its primary activity was placing children for adoption in a manner indistinguishable from that of a commercial adoption agency. The court rejected the organization's argument that the adoption services merely complemented the health related services to unwed mothers and their children. Rather, the court found that the health-related services were merely incident to the organization's operation of an adoption service, which, in and of itself, did not serve an exempt purpose. The organization's sole source of support was the fees it charged adoptive parents, rather than contributions from the public. The court also found that the organization competed with for-profit adoption agencies, engaged in substantial advertising, and accumulated substantial profits. Accordingly, the court found that the "business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal" and held that the organization was not operated exclusively for purposes described in section 501(c)(3). Easter House, 12 Cl. Ct. at 485-486.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the court held that an organization that operated a school to train individuals for careers as political campaign professionals, but that could not establish that it operated on a nonpartisan basis, did not exclusively serve purposes described in section 501(c)(3) of the Code because it also served private interests more than incidentally. The court found that the organization was created and funded by persons affiliated with entities of a particular political party and that most of the organization's graduates worked in campaigns for the party's candidates. Consequently, the court concluded that the organization conducted its educational activities with the objective of benefiting the party's candidates and entities. Although the candidates and entities benefited were not organization "insiders," the court stated that the conferral of benefits on disinterested persons who are not members of a charitable class may cause an organization to serve a private interest within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the regulations. The court concluded by stating that even if the political party's candidates and entities did "comprise a charitable class, [the

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organization] would bear the burden of proving that its activities benefited members of the class in a non-select manner."

In Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), the court held that an organization that marketed handicrafts made by disadvantaged artisans through museums and other nonprofit organizations and shops was operated for exclusively charitable purposes within the meaning of section 501(c)(3) of the Code. The organization, in cooperation with national craft agencies, selected the handicrafts it would market from craft cooperatives in communities identified as disadvantaged based on objective evidence by the Bureau of Indian Affairs or other government agencies. The organization marketed only handicrafts it purchased in bulk from these communities of craftsmen. It did not select individual craftsmen based on the needs of the purchasers. The court concluded that the overall purpose of the activity was to benefit disadvantaged communities. The organization's commercial activity was not an end in itself but merely the means through which the organization pursued its charitable purposes. The method it used to achieve its purpose did not cause it to serve primarily private interests because the disadvantaged artisans directly benefited by the activity constituted a charitable class and the organization showed no selectivity with regard to benefiting specific artisans. Therefore, the court held that the organization operated exclusively for exempt purposes.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test to an organization that operated a conference center as its primary activity and derived most of its revenues from user fees. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. In reaching this conclusion, the court stated that "[a]mong the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia*, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

Revenue Ruling 67-138, 1967-1 C.B. 129, held that helping low income persons obtain adequate and affordable housing is a "charitable" activity because it relieves the poor and distressed or underprivileged. The organization carried on several activities directed to assisting low-income families obtain improved housing, including (1) coordinating and supervising joint construction projects, (2) purchasing home sites for resale at cost, and (3) helped low income people obtain home construction loans.

Revenue Ruling 70-585, 1970-2 C.B. 115, discussed four situations of organizations providing housing and whether each qualified as charitable within the meaning of section 501(c)(3) of the Code. Situation 1 described an organization formed to construct new homes and renovate existing homes for sale to low-income families who could not obtain financing through conventional channels. The organization also provided financial aid to eligible families who do not have the necessary down payment. When possible, the organization recovered the cost of the homes through very small periodic payments, but its operating funds were obtained from federal

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loans and contributions from the general public. The revenue ruling held that by providing homes for low-income families who otherwise could not afford them, the organization relieved the poor and distressed.

Situation 2 described an organization formed to ameliorate the housing needs of minority groups by building housing units for sale to persons of low and moderate income on an open-occupancy basis. The housing was made available to members of minority groups who were unable to obtain adequate housing because of local discrimination. The housing units were located to help reduce racial and ethnic imbalances in the community. As the activities were designed to eliminate prejudice and discrimination and to lessen neighborhood tensions, the revenue ruling held that the organization was engaged in charitable activities within the meaning of section 501(c)(3) of the Code.

Situation 3 described an organization formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. The median income level in the area was lower than in other sections of the city and the housing in the area was generally old and badly deteriorated. The organization developed an overall plan for the rehabilitation of the area; it sponsored a renewal project; and involved residents in the area renewal plan. The organization also purchased apartment buildings that it rehabilitated and rented at cost to low and moderate income families with a preference given to residents of the area. The revenue ruling held that the organization is described in section 501(c)(3) of the Code because its purposes and activities combated community deterioration.

Situation 4 described an organization formed to alleviate a shortage of housing for moderate-income families in a particular community. The organization planned to build housing to be rented at cost to moderate-income families. The revenue ruling held that the organization failed to qualify for exemption under section 501(c)(3) of the Code because the organization's program was not designed to provide relief to the poor or further any other charitable purpose within the meaning of section 501(c)(3) and the regulations

Revenue Ruling 2006-27, 2006-21 I.R.B. 915, sets forth standards for determining when an organization that provides funds to homebuyers for down payment or closing costs qualifies for exemption from Federal income tax under section 501(c)(3). In Situation 2, an organization provides down payment assistance to low-income individuals and families. It offers financial counseling seminars and conducts other educational activities to help prepare potential low-income homebuyers for the responsibility of home ownership. Under the organization's grant making procedures, the staff considering a particular applicant's application knows the identity of the party selling the home to the grant applicant and may also know the identities of other parties, such as real estate agents and developers, who may receive a financial benefit from the sale. Moreover, in substantially all of the cases in which the organization provides down payment assistance to a homebuyer, the organization receives a payment from the home seller. Further, there is a direct correlation between the amount of the down payment assistance provided by the organization to the homebuyer and the amount of the home seller's payment to the organization. Finally, the organization does not conduct a broad based fundraising campaign to attract financial support. Rather, most of the organization's support comes from home sellers and real estate-

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related businesses that may benefit from the sale of homes to buyers who receive the organization's down payment assistance.

The revenue ruling holds that the organization described in Situation 2 is not exempt from Federal income tax under section 501(c)(1) because it finances its down payment assistance activities with contributions from sellers and individuals that stand to benefit from the transactions that the organization facilitates. The fact that the organization relies on seller's payments for most of its funding and in substantially all of the transactions the payment from a home seller corresponds to the amount that the organization gives to a homebuyer indicate that the benefit to the home seller is a critical aspect of an organization's operations. Rev. Rul. 2006-27, also holds that the payments to homebuyers in Situation 2 are not gifts, but rebates or purchase price reductions because sellers make the payments not out of detached and disinterested generosity, but in response to an anticipated economic benefit, namely the sale of their home at a higher price and in less time.

Revenue Ruling 2006-27, Situations 1 and 3 describe organizations that provide down payment and closing costs to qualified homebuyers, in the manner that could qualify for exemption from Federal income tax under section 501(c)(3). In Situation 1, the organization's purposes and activities relieve the poor, distressed and underprivileged by enabling low-income individuals and families to obtain decent, safe and sanitary homes. In Situation 3, the organization's purposes and activities combat community deterioration in a specific, economically depressed area that has suffered a major loss of population and jobs. Importantly, these organizations conduct broad based fundraising programs to attract gifts, grants, and contributions from several foundations, businesses, the general public, and receive funding from government agencies. See Rev. Rul. 2006-27. Their policies and procedures prevent the grant making staff from knowing identities of the parties involved in the transaction and whether anyone related to the transaction had made or agreed to make or made a contribution to the organization.

TAXPAYER'S POSITION:

ORG's position with respect to the issues, facts, applicable law and government's position as discussed in this report is unknown. ORG will be allowed 30 days to review this report and respond with a rebuttal if considered necessary.

GOVERNMENT'S POSITION:

ORG does not qualify as an organization described in Internal Revenue Code §501(c)(3) because it operates a program that (1) does not exclusively serve an exempt purpose described in §501(c)(3), (2) provides substantial private benefit to persons who do not belong to a charitable class, and (3) results in inurement a part of ORG's income to the benefit of an officer of the organization.

Charitable purposes include relief of the poor and distressed. See §1.501(c)(3)-1(d)(2) of the regulations. ORG's down payment assistance program does not operate in a manner that

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establishes that its primary purpose is to address the needs of low-income people by enabling low-income individuals and families to obtain decent, safe housing. See Revenue Ruling 70-585, Situation 1. The down payment assistance program did not serve exclusively low-income persons. Despite the representations in its application for exemption, ORG does not have any income limitations for participation in its DPA program. ORG did not screen applicants for down payment assistance based on income. ORG's records do not include data on the buyers' incomes.

Instead, the program is open to anyone, without any income limitations, who otherwise qualified for these loans. ORG's DPA program does not limit assistance to certain geographic areas or target those areas experiencing deterioration or neighborhood tensions. See Revenue Ruling 70-585, Situation 4. Down payment assistance is available for any property that is otherwise able to qualify for a mortgage. Arranging or facilitating the purchase of homes in a broadly defined geographic area does not combat community deterioration or serve other social welfare objectives within the meaning of §501(c)(3) of the Code.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279, 283 (1945), the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if ORG's DPA program were directed to exclusively low-income individuals or disadvantaged communities, ORG's total reliance for financing its DPA activities on home sellers or other real-estate related businesses standing to benefit from the transactions demonstrates that the program is operated for the substantial purpose of benefiting private parties.

Like the organization considered in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), ORG is structured and operated to assist the private parties who fund it and give it business. Sellers who participate in ORG's DPA program benefit from achieving access to a wider pool of buyers, thereby decreasing their risk and the length of time the home is on the market. They also benefit by being able to sell their home at the home's full listed price or by being able to reduce the amount of the negotiated discount on their homes. Also, the fees paid to CO-1 benefit the owners of that business. It is evident from the foregoing that ORG's DPA program provides ample private benefit to the various parties in each home sale.

As can be seen from the information in the documents utilized in ORG's DPA program, buyers receive a "gift" of the funds that they use for the down payment. A house buyer was eligible to participate in ORG's DPA program only if the buyer purchased a house from a seller that agreed to ORG's contractual terms. ORG and sellers entered into agreements that required sellers to pay ORG an amount equal to the down payment "gift" that the buyer received under ORG's DPA program. ORG claimed that the seller's payment was not provided directly to the buyer, but instead it was used to "replenish" the pool of funds that was used to provide "gifts" to subsequent buyers. In addition to requiring the seller to pay an amount equal the amount of the "gift" provided to the house buyer, ORG required sellers to pay an "administrative fee of \$ to CO-1.

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In addition, ORG documents explicitly state that the down payment “gift” to a buyer comes from preexisting ORG funds rather than from the seller’s “contribution” in the transaction. However, ORG did not solicit outside public contributions or have any other source of funds other than “contributions” from sellers and related fees. Because the amount of the “contribution” is always equal to the amount of the down payment assistance provided to the buyer plus the service fee, the actual source of the down payment assistance is in fact the seller’s “contribution.”

In essence, these transactions result in a circular flow of the money. The sellers make payments to ORG. ORG provides the funds to the buyers, who use the funds to make the down payment necessary to purchase the seller’s home.

On its contract with each seller ORG in error labeled the seller’s payment to ORG as both a “gift” and a replenishment amount. These contracts obligate the seller, in consideration for participating in ORG’s program, to pay ORG an amount equal to the amount of the DPA received by the buyer. The contract, which was required to be signed by each participating seller, stated: “. Payment of this contribution is NOT required if the Buyer does not purchase the Subject Property.”

The manner in which ORG operated its DPA program shows that the private benefit to the various participants in ORG’s activities was the intended outcome of ORG’s operations rather than a mere incident of such operations. ORG’s down payment assistance procedures are designed to channel funds in a circular manner from the sellers to the buyers and back to the sellers in the form of increased home prices. To finance its down payment assistance activities, ORG relies exclusively on sellers that stand to benefit from the transactions it facilitates. ORG neither solicits nor receives funds from other sources.

Before providing down payment assistance, ORG’s grantmaking staff takes into account whether there is a home seller willing to make a payment to cover the down payment assistance the applicant has requested. ORG requires the home seller to reimburse it, dollar-for-dollar, for the amount of funds expended to provide down payment assistance on the seller’s home, plus an administrative fee of several hundred dollars per home sale. ORG secures an agreement from the seller stipulating to this arrangement prior to the closing.

No DPA assistance transactions take place unless ORG is assured that the amount of the down payment plus the fee is or will be paid by the seller upon closing. ORG’s instructions to title and escrow companies provide that at the close of escrow the seller’s contribution, along with any ORG fees, must be sent to ORG within 72 hours. Escrow companies that do not appropriately disburse funds in a timely manner are prohibited from utilizing the ORG DPA program.

ORG’s receipt of a payment from the home seller corresponding to the amount of the down payment assistance in virtually every transaction indicates that the benefit to the home seller (and others involved in the transaction) is not a mere accident but rather an intended outcome of ORG’s operations. In this respect, ORG is like the organization considered in Easter House which provided health care to indigent pregnant women, but only when a family willing to adopt a woman’s child sponsored the care financially.

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Operating a trade or business of facilitating home sales is not an inherently charitable activity. Unlike the trade or business in Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978), ORG's trade or business was not utilized as a mere instrument of furthering charitable purposes but was an end in itself. ORG provided services to home sellers for which it charged a market rate fee. ORG did not market its services primarily to persons within a charitable class. ORG did not solicit or receive any funds from parties that did not have interest in the down payment transactions. Like the organizations considered in American Campaign Academy, supra, and Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987), aff'd, 846 F. 2d 78 (Fed. Cir.) a substantial part of ORG's activities furthered commercial rather than exempt purposes.

Based on the foregoing, ORG has not operated exclusively for exempt purposes, and, accordingly, is not entitled to exemption under §501(c)(3).

The payments from the home sellers to ORG do not qualify as gifts under §102. The payments from the home sellers do not proceed from detached and disinterested generosity but, rather, in response to an anticipated economic benefit, namely facilitating the sale of the seller's home. Under Commissioner v. Duberstein, 363 U.S. 278 (1960), such payments are not gifts for purposes of §102.

The government proposes revoking ORG's exemption. Furthermore, although ORG has an educational module on its website, ORG did not obtain verification from buyers that they had reviewed or completed the module. Revocation of a determination letter may be retroactive if the organization operated in a manner materially different from that originally represented. Income Tax Regulation §601.201(n)(6)(i), Revenue Procedure 20XX-4, §14.01. ORG's operation of its DPA activities in a manner materially different from that represented in its application for exemption justifies retroactive revocation of ORG's determination letter.

CONCLUSION:

In order to qualify for exemption under IRC §501(c)(3) an organization must be both organized and operated to achieve a purpose that is described under that Code section. ORG's DPA program is not operated in accordance with Internal Revenue Code §501(c)(3) and the regulations thereunder governing qualification for tax exemption under Code. ORG provides down payment assistance, purportedly in the form of a gift, to individuals and families for the purchase of a home.

ORG does not screen the applicants for its downpayment assistance program as the organization is not involved in the process until step 3 of the process. The buyer and seller have negotiated the sale before an application is made to ORG. ORG's DPA activities do not target neighborhoods in need of rehabilitations or other relief such as lessening neighborhood tensions or eliminating prejudice and discrimination the home sale transactions were for homes located all over the City area.

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ORG's primary activity was brokering transactions to facilitate the selling of homes. ORG does not engage in any counseling or other activities that further charitable purposes. Because ORG's primary activity is not conducted in a manner designed to further §501(c)(3) purposes, ORG is not operated exclusively for exempt purposes within the meaning of §501(c)(3).

All of this constitutes evidence that assets and/or earnings of ORG inured to ORG's insiders in violation of the requirements of §501(c)(3).

For the foregoing reasons, revocation of exempt status is proposed. Because the facts show that, in 20XX and 20XX, ORG operated a DPA program not in accordance with the correct practices, it is proposed that ORG's tax exempt status be revoked as of January 1, 20XX.